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Legal Update

UK LawTech Delivery Panel publishes legal statement: cryptoassets constitute property under common law principles

There are today at least 2,352 different types of cryptocurrencies being traded on various exchanges[1]. As legislators, regulators, financial institutions, and other businesses have been seeking to understand the opportunities and risk presented by cryptocurrencies, smart contracts, and other fast-moving Fintech developments since the launch of Bitcoin around 10 years ago, on 18 November 2019 the UK Jurisdiction Taskforce of the Lawtech Delivery Panel published a Legal Statement[2] in relation to cryptoassets and smart contracts, following a period of public consultation. The Legal Statement concludes that cryptoassets should generally be considered, and are, a form of personal property under English law. This Legal Update summarises the key features of the Legal Statement and explores some of its potential implications and consequences.

Background to the Legal Statement

The Lawtech Delivery Panel is an industry-led, government-backed initiative, "*established to support the transformation of the UK legal sector through tech*". As indicated in the foreword to the Legal Statement by Sir Geoffrey Vos, Chancellor of the High Court, the aim of the Legal Statement is "*to provide the best possible answers to the critical legal questions under English law*". It is said that "*the great advantage of the English common law system is its inherent flexibility*", and the Legal Statement is intended to demonstrate this by stating the English law position as it currently stands, by analysing the relevant legal principles and authorities insofar as they may be brought to bear on cryptoassets and smart contracts, in order to provide a starting point from which legislators, regulators, and the markets might proceed. In this respect, the approach taken in the Legal Statement may be contrasted with the approaches of other jurisdictions, which have generally sought to introduce rules and regulations on cryptoassets without a public analysis or statement about their legal status.

Although the Legal Statement is not legally binding, given the context in which it has been produced, and the prominent status of its authors and endorsers, it seems likely to be regarded as persuasive as a matter of legal authority.

What is a cryptoasset?

As there are many different kinds of cryptoassets, some with materially different features and ways of operating, the Legal Statement seeks to define cryptoassets by reference to the key and distinctive characteristics they have in common. These are as follows:

(a) they are intangible in that they cannot be physically touched, held, or possessed;

1 Coinmarketcap.com, a platform which tracks the market value of cryptocurrencies

2 The Legal Statement may be accessed here

(b) they are transferred, controlled, and otherwise dealt with by means of cryptographic authentication, i.e. a sophisticated form of password known as a private key;

(c) they all use some form of distributed transaction ledger;

(d) they are decentralised in that there is no central authority responsible for maintaining the ledger; and

(e) the governing rules for each cryptoasset are established by the informal consensus of its participants.

What is property?

Proprietary rights are enforceable by a person in relation to a thing as against the whole world, in contrast with personal rights, which may only be enforced as against certain other persons. However, as the Legal Statement observes, under English law, there is no comprehensive or universal definition of "property". Whether a thing constitutes property, and what constitutes property, may differ on a case by case basis, and may depend on the purpose for which the issue is considered.

The Legal Statement cites the authoritative judgment of Lord Wilberforce in *National Provincial Bank v Ainsworth*[3] in identifying what English law recognises as the characteristics of property. In order for something to be property, it must be:

(a) definable;

(b) identifiable by third parties;

(c) capable of assumption by third parties; and

(d) permanent and stable, to some extent.

The Legal Statement examines each of these "*indicia of property*" by reference to the relevant case law, and concludes that "*cryptoassets possess all the characteristics of property set out in the authorities*":

(a) the public parameters of a cryptoasset, which contain information regarding the asset including its ownership, value, and transaction history, define the asset and identify it. The public parameters of the asset thus also make it identifiable by third parties;

(b) control and exclusivity over a cryptoasset is exercised by use of the holder's private key, which entitles the holder to transfer and deal with the asset to the exclusion of others;

(c) generally, cryptoassets are capable of assumption by third parties in the sense that they can be transferred and assigned;

(d) as for permanence and stability, although theoretically a "forking" in a cryptosystem may lead to it dividing into separate systems with separate rules and ledgers, cryptoassets are said to be "*in our view sufficiently permanent or stable to be treated as property*", and the Legal Statement also observes that "*even conventional assets are at risk of deterioration, corruption or loss*".

The conclusion that cryptoassets constitute property as defined in *National Provincial Bank v Ainsworth* is consistent with a decision of the Singapore International Commercial Court in *B2C2 Ltd v Quoine Ptd Ltd*[4], where the Court also held, and it was common ground, that cryptoassets could form the subject of a trust.

Cryptoassets as mere information?

The Legal Statement addresses a potential issue under the common law, which is the general principle that pure information cannot be regarded as property (intellectual property rights being an exception established by statute). Is a cryptoasset merely information? The Legal Statement's position is that it is not: a cryptoasset is not merely the data parameters of the asset, nor merely the private key, but a combination of these, along with the rules of the relevant system in which it exists. Accordingly, a cryptoasset is not mere information and so is not disqualified from constituting property on this basis.

What kind of property is a cryptoasset?

The Legal Statement goes on to consider different types of property recognised under English law. These are:

(a) real property (i.e. land); and

(b) personal property (i.e. anything other than land).

3 [1965] AC 1175

4 [2019] SGHC(I) 03

In turn, personal property is said to comprise two, or arguably three, different types:

(a) things (otherwise known as "choses") in possession;

(b) things in action;

(c) things other than things in possession or things in action.

The Legal Statement observes that the cryptoassets cannot be things in possession because they are intangible and therefore cannot be physically possessed.

The key, and more difficult, question which the Legal Statement considers is whether a cryptoasset is a thing in action, the scope and definition of which has been uncertain, or the third category of personal property, the existence of which has also been debated.

The traditional understanding of a thing in action is a thing over which rights are enforceable by way of Court action, such as a debt or a contractual right. If a "*thing in action*" is understood in this narrower, traditional sense, it is doubted that a cryptoasset is a thing in action. As the Legal Statement observes, on this basis, "*a cryptoasset would not normally be thing in action on that definition…[because] in many systems the cryptoasset does not itself embody any right capable of being enforced by action. In a fully decentralised system with consensus rules, such as Bitcoin, participants do not undertake any legal obligations to each other*". If, however, "*thing in action*" is understood in a broader sense of including any personal thing other than things in possession, a cryptoasset would be a thing in action.

The Legal Statement considers a long line of common law cases stretching back to 1885 in relation to whether a third category of personal property exists outside things in possession and things in action, and concludes that there is no reason why that third category cannot exist under English law.

Accordingly, a cryptoasset is either a thing in action in the broader sense, or alternatively it falls within the third category of personal property of being neither a thing in possession or a thing in action.

Implications and consequences

The Legal Statement examines some of the consequences of its analysis and conclusions, by responding to "*ancillary questions*" posed as part of the public consultation. Its responses are summarised below.

(a) Given that a cryptoasset is not capable of possession, it cannot be the object of any form of bailment (where a temporary transfer of possession, but no transfer of ownership, is made for a specific purpose, e.g. pending repayment of a debt to a pawnbroker).

(b) A cryptoasset can, however, still in principle be the subject of security. There is no reason in principle why a mortgage or equitable charge cannot be created over a cryptoasset, although given that cryptoassets cannot be possessed, they cannot be the object of a pledge or lien. There may be complications as to the mechanism for the provision of a cryptoasset as a security given that knowledge of the private key will – by itself - enable and entitle whoever has it to transfer and deal with the asset.

(c) Cryptoassets fall under the definition of "*property*" under the Insolvency Act 1986.

(d) A cryptoasset cannot be characterised as a documentary intangible, a document of title, a negotiable instrument, or an instrument under the Bills of Exchange Act 1882, given that each of these relates to physical documents capable of possession.

(e) Whether cryptoassets can be characterised as goods under the Sale of Goods Act 1979 depends on whether things in action are understood in their narrower or broader sense, given that the definition of "*goods*" under Section 61(1) Sale of Goods Act 1979 "*includes all personal chattels other than things in action and money…*". In other words, if cryptoassets are considered to fall under the third category of personal property, they might fall under the above definition of "*goods*".

(f) The distributed ledger is generally evidence of, but cannot be treated as definitive record of, legal rights to cryptoassets.

Smart contracts

In relation to smart contracts. the Legal Statement concludes that their central characteristic feature is "*automaticity*": smart contracts are performed in whole or in part automatically and without the need for human intervention, because their terms are recorded in computing code and are often embedded in a networked system. In this sense, the code will (and can) never do anything other than what it has been programmed to do.

As the Legal Statement observes, however, this does not mean that the conventional contract law analysis does not apply. Under English law, in order for an agreement to be legally binding, there must be an offer which is accepted, there must be consideration, and the parties must intend to create legal relations. These criteria still apply in relation to smart contracts, and so whether a smart contract is legally binding and enforceable will still depend on whether it fulfils these criteria.

Even if the terms of a smart contract exist solely in code, there may still be cases involving issues of contractual interpretation – for example, if a party asserts that there is an error in the code, or that the code does not operate as the parties had intended. It may be necessary for the Court to look beyond the code in certain circumstances where, for example, the factual matrix of the contract may be required to assist with the interpretation of the contract terms, or where a contract is allegedly entered into in circumstances involving duress, fraud, misrepresentation, or other factors which may have vitiated the intention or consent of a party.

Conclusions

As the Legal Statement makes clear, due to the nature of the common law and the way in which it is shaped by Court judgments, there already is an English law position in respect of cryptoassets and smart contracts and the issues they present. Accordingly, the Legal Statement's analysis and conclusions will not be particularly surprising or novel to English lawyers, or indeed the common law world at large.

What remains to be seen is how the issues which arise out of the Legal Statement's conclusions will be addressed by the law (whether statutory, regulatory, or judge-made) and by market practice. For example, how will existing, or new, regulations be brought to bear on cryptoassets? To what extent will or should dealing in cryptoassets be a regulated activity?

In the Final Guidance on Cryptoassets published by the UK Financial Conduct Authority (the "**FCA**") in July 2019, the FCA confirmed the position that "exchange tokens" - i.e. decentralised cryptoassets (e.g. Bitcoin) in respect of which the holder has limited or no rights and no issuer to enforce rights against - are outside the regulatory perimeter and therefore not within the FCA's remit. The Final Guidance also observes that authorised firms' conduct of unregulated activities are in general still subject to some FCA rules; for example, pursuant to the overarching Principles for Business or the Senior Managers and Certification Regime. Similarly, it could be said that the Fifth Money Laundering Directive ("**5MLD**"), which must be implemented in all EU Member States by 10 January 2020, has made a start in addressing some of the financial crime risks associated with cryptoassets. As the preamble to the Directive observes, "*the anonymity of virtual currencies allows their potential misuse for criminal purposes*". The Directive brings some cryptoasset activities within the current AML regime, and requires crypto-fiat currency exchanges and providers of cryptocurrency wallet services (which hold users' private keys) to perform AML / CFT due diligence checks on its customers.

It is worth noting, however, that – anonymity aside - other characteristics of cryptoassets might mean that the financial crime risks are actually lower than for fiat currencies, because every asset's transaction history will be contained within its data parameters within the blockchain and so it should be virtually impossible for an asset to be dissipated in the sense of being untraceable. Ultimately, how cryptoassets are legislated or regulated may prove to be event- or politically driven.

Another question, in light of the Legal Statement's conclusion that cryptoassets are a form of property, is how property-related remedies under the common law will apply to cryptoassets. As noted above, the Legal Statement refers to a Singaporean case where it was held that cryptoassets could form the subject of a trust. The Legal Statement also indicates that, in principle, it is possible to have some forms of security over cryptoassets. How will this work in the absence of a central register?

Again, given that ownership is anonymous and knowledge of the private key is alone determinative, how in practice would one grant security over an asset, if the grantor of the security will presumably still have knowledge of the private key and so can still transfer the asset? Similarly, how would one police and enforce a freezing injunction which covers a cryptoasset? The recent decision of the English High Court in *Vorotyntseva v. Money 4 Limited and others*[5] demonstrates that it is possible under English law to have a proprietary freezing injunction over cryptoassets, but does not address how the injunction would be enforceable in practice in the event that the respondent (in breach of the freezing injunction) were to transfer or dissipate the asset simply by using the private key. This is unlike, say, an injunction freezing funds in a bank account, which would be served on the (third party) bank so that it would not effect transactions out of the account in breach of the injunction. In the absence of a centralised authority or ledger, it is unclear precisely how one would or could physically prevent a respondent from continuing to deal with its cryptoassets by using the private key.

A further area in which the Legal Statement identifies issues requiring clarification without providing settled conclusions is how conflicts of laws rules will apply to a particular cryptoasset or cryptoasset related transaction or dispute. Cryptoassets, by their nature, are traded in a world without borders, as recorded and facilitated by a ledger not situate in any specific jurisdiction(s). What law applies to the asset or transactions relating to the asset? In what jurisdiction(s) is a cryptoasset located? In what jurisdiction(s) can legal proceedings regarding a cryptoasset be commenced? The position is further complicated by the fact that every jurisdiction will have its own set of conflicts of laws rules which it will apply to these questions. The Legal Statement indicates that the issues would be best resolved by international treaties and domestic legislation, but also tentatively provides a few examples of indicators which could point to English law governing the proprietary features of a cryptoasset: if the off-chain asset is in England; if there is a centralised control in England; if the person with control over the asset is in England; and if the parties dealing with the asset have chosen English law to govern.

The Legal Statement does not purport to answer all legal questions about cryptoassets and smart contracts, but what it does do is provide a starting point to that undertaking. Hopefully, it will in practice provide a platform on which the common law, legislators, and regulators can further develop the rules and principles surrounding cryptoassets and smart contracts, in line with continued development and use of these technologies.

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5 [2018] EWHC 2596 (Ch)